

**DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE OF HAWAII**

FINANCIAL STATEMENTS WITH ACCOMPANYING INFORMATION

FOR THE YEAR ENDED JUNE 30, 2002

AND

INDEPENDENT AUDITORS' REPORT

GERALD Y. USHIJIMA

Certified Public Accountant

Department of Accounting and General Services State of Hawaii

**Financial Statements with Accompanying
Information for the Year Ended June 30, 2002 and
Independent Auditors' Report**

DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

STATE OF HAWAII

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	2
MANAGEMENT'S DISCUSSION AND ANALYSIS	4
BASIC FINANCIAL STATEMENTS:	
GOVERNMENT-WIDE FINANCIAL STATEMENTS:	
Statement of Net Assets	15
Statement of Activities	17
FUND FINANCIAL STATEMENTS:	
Balance Sheet - Governmental Funds	18
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	19
Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds	20
Reconciliation of Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	21
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual (Budgetary Basis) - General Fund	22
Statement of Net Assets - Proprietary Funds	23
Statement of Revenues, Expenses, and Changes in Net Assets - Proprietary Funds	24
Statement of Cash Flows - Proprietary Funds	25
Statement of Fiduciary Net Assets - Fiduciary Funds	27
NOTES TO BASIC FINANCIAL STATEMENTS	28
SUPPLEMENTARY INFORMATION:	
Combining Balance Sheet - General Fund Programs	48
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances - General Fund Programs	49
Combining Balance Sheet - Nonmajor Governmental Funds	50
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances - Nonmajor Governmental Funds	51
AUDITORS' REPORT ON FEDERAL AWARDS:	
Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	52
Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133	54
Schedule of Expenditures of Federal Awards	57
Note to Schedule of Expenditures of Federal Awards	58
Schedule of Findings and Questioned Costs	59



GERALD Y. USHIJIMA
CERTIFIED PUBLIC ACCOUNTANT

1110 UNIVERSITY AVE. SUITE 508
HONOLULU, HAWAII 96826
TEL: (808) 949-5588
FAX: (808) 949-2666
E-MAIL: GYUCPA@AOL.COM
WWW.USHIJIMACPA.COM

INDEPENDENT AUDITORS' REPORT

Comptroller
State of Hawaii:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the Department of Accounting and General Services, State of Hawaii, as of and for the year ended June 30, 2002, which collectively comprise the Department of Accounting and General Services, State of Hawaii's basic financial statements, as listed in the foregoing table of contents. These financial statements are the responsibility of the management of the Department of Accounting and General Services, State of Hawaii. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the proprietary fund types and component unit. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions expressed herein, insofar as they relate to the amounts included for the proprietary fund types and component unit, are based solely upon the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinions.

As discussed in Note 1 to the basic financial statements, the financial statements of the Department of Accounting and General Services, State of Hawaii, are intended to present the financial position and the changes in financial position; and cash flows of the proprietary fund types, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department of Accounting and General Services, State of Hawaii. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2002, and the changes in the financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, based upon our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the Department of Accounting and General Services, State of Hawaii, as of June 30, 2002, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the General Fund for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the basic financial statements, the Department of Accounting and General Services, State of Hawaii, adopted Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Note Disclosures*, and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, effective July 1, 2001.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 28, 2003 on our consideration of the Department of Accounting and General Services, State of Hawaii's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 4 through 14 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no such opinion on it.

Our audit was made for the purpose of forming opinions on the financial statements that collectively comprise the Department of Accounting and General Services, State of Hawaii's basic financial statements. The accompanying financial information presented on pages 48 through 51 is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.



March 28, 2003

STATE OF HAWAII

DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

Management's Discussion and Analysis

June 30, 2002

The Department of Accounting and General Services (the Department), State of Hawaii (the State), was created in 1959 by the Hawaii State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawaii 1959). The primary function of the Department is to provide professional and technical expertise to state agencies and to enforce compliance with accounting and internal control systems.

As management of the Department, we offer readers of these basic financial statements this narrative overview and analysis of the financial activities of the Department for the year ended June 30, 2002. This discussion and analysis is designed to assist the reader in the analysis of the Department's financial activities based on currently known facts, decisions and conditions. We encourage readers to consider the information presented here in conjunction with the basic financial statements.

Overview of the Basic Financial Statements

This discussion and analysis are intended to serve as an introduction to the Department's basic financial statements. The Department's basic financial statements consist of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to basic financial statements. This report also contains other supplementary information in addition to the basic financial statements.

The Department adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, effective July 1, 2001. Accordingly, comparative data for the year ended June 30, 2001 are not available for a comprehensive discussion of the change in net assets. However, comparative analysis of government-wide data will be presented in the financial statements in future years.

Government-Wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Department's finances, in a manner similar to a private sector business.

The statement of net assets presents information on all of the Department's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in

net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.

The statement of activities presents information showing how the Department's net assets changed during the most recent fiscal year. Functional activities are highlighted in this statement, with functional expenses shown net of related program revenue. This statement shows the extent to which the various functions depend on state appropriations and other non-program revenues for support.

Both of the government-wide financial statements distinguish functions of the Department that are principally supported by state appropriations and other non-program revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The business-type activities of the Department include the State Parking Revolving Fund and the State Motor Pool Revolving Fund.

The government-wide financial statements include not only the Department itself (known as the Primary Government), but also the activities of the legally separate Stadium Authority, a component unit of the State that is administratively attached to the Department. Financial information for the Stadium Authority is reported separately from the financial information presented for the Department itself.

The government-wide financial statements can be found immediately following this discussion and analysis.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Department can be divided into three categories: (1) governmental funds; (2) proprietary funds; and (3) fiduciary funds.

Governmental Funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on the balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Department's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Department's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes

in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities in the government-wide financial statements.

The Department maintains three individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund and Capital Projects Fund, which are considered to be major funds. Data from the remaining governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining financial statements immediately following the notes to basic financial statements.

The Department adopts an annual appropriated budget for its General Fund and Special Revenue Funds. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found immediately following the government-wide financial statements.

Proprietary Funds

Proprietary funds are used to show activities that operate more like those of commercial enterprises. They are known as Enterprise Funds and Internal Service Funds because they charge fees for services provided to outsiders and other state agencies. They are used to report the same functions presented as business-type activities in the government-wide financial statements. The Department uses an Enterprise Fund to account for the operations of the State Parking Revolving Fund and an Internal Service Fund to account for the operations of the State Motor Pool Revolving Fund.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the State Parking Revolving Fund and the State Motor Pool Revolving Fund.

The basic proprietary fund financial statements can be found immediately following the governmental fund financial statements.

Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the Department. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the Department's own programs.

The basic fiduciary fund financial statements can be found immediately following the proprietary fund financial statements.

Notes to Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to basic financial statements can be found immediately following the fiduciary fund financial statements.

Other Supplementary Information

Combining Financial Statements

Combining financial statements of General Fund programs and nonmajor Special Revenue Funds are presented immediately following the notes to basic financial statements.

The financial highlights and analysis which follow focus on the Primary Government (governmental and business-type activities of the Department).

Financial Highlights

- The assets of the Department exceeded its liabilities at June 30, 2002 by \$697,651,360 (net assets). Of this amount, \$23,402,570 (unrestricted net assets) may be used to meet the Department's ongoing obligations.
- The Department's total net assets increased by \$27,974,755 during the current fiscal year.
- At June 30, 2002, the Department's governmental funds reported combined ending fund balances of \$307,765,363, an increase of \$40,352,583 from the prior fiscal year. Of this amount, \$1,945,139 or 0.63% of total fund balances are available for spending at the Department's discretion (unreserved fund balance).
- At June 30, 2002, the General Fund had no unreserved fund balance.

Government-Wide Financial Analysis

This is the first year that the Department has presented its financial statements under the new reporting model required by GASB Statement No. 34. Because this reporting model changes significantly the presentation of financial data, the Department has not restated prior fiscal years for the purpose of providing comparative information for the MD&A. In future years, when prior year information is available, a comparative analysis of government-wide data will be presented.

Net Assets
June 30, 2002
(Amounts in thousands)

	Primary Government		
	Governmental Activities	Business – Type Activities	Total
Assets:			
Current and other assets	\$ 358,467	\$ 8,877	\$ 367,344
Capital assets	355,305	36,129	391,434
Total assets	713,772	45,006	758,778
Liabilities:			
Long-term liabilities	17,582	2,112	19,694
Other liabilities	40,710	723	41,433
Total liabilities	58,292	2,835	61,127
Net assets:			
Invested in capital assets, net of related debt	355,305	33,903	389,208
Restricted	285,041	—	285,041
Unrestricted	15,134	8,268	23,402
Total net assets	\$ 655,480	\$ 42,171	\$ 697,651

By far the largest portion of the Department's net assets reflects its investment in capital assets (e.g., land and improvements, historical treasures, works of art, buildings and improvements, equipment, furniture and fixtures and motor vehicles), less any related debt used to acquire those assets that is still outstanding. The Department uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the Department's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Department's net assets represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets may be used to meet the Department's ongoing obligations to creditors.

At June 30, 2002, the Department is able to report positive balances in all three categories of net assets, both for the Department as a whole, as well as for its separate governmental and business-type activities.

Changes in Net Assets

The Department's net assets increased by \$27,974,755 or 6.3%. Approximately 93.6% of the Department's total revenues came from state allotments, while 0.16% resulted from grants and contributions (including federal aid). Charges for various goods and services

provided 5.9% of the total revenues. The Department's expenses cover a range of services. The largest expenses were for school repairs and maintenance, public building maintenance, and office leasing.

A comparison of the cost of services by function of the Department's governmental activities is shown below, along with the revenues used to cover the net expenses for the governmental activities.

Change in Net Assets
For the Year Ended June 30, 2002
(Amounts in thousands)

	Primary Government		
	Governmental Activities	Business – Type Activities	Total
Revenues:			
Program revenues:			
Charges for services	\$ 13,850	\$ 5,311	\$ 19,161
Operating grants and contributions	530	—	530
General revenues:			
State allotments, net of lapsed appropriations	305,377	—	305,377
Interest and investment income	783	311	1,094
Other	53	—	53
Total	<u>320,593</u>	<u>5,622</u>	<u>326,215</u>
Expenses:			
Administration and support	2,431	—	2,431
State procurement	1,907	—	1,907
Public building maintenance	20,370	—	20,370
Accounting	2,277	—	2,277
Audit	1,661	—	1,661
Performing and visual arts	3,920	—	3,920
School repairs and maintenance	29,627	—	29,627
Office leasing	16,216	—	16,216
Information processing services	13,530	—	13,530
Communications	2,190	—	2,190
Parking control	—	3,982	3,982
Motor pool	—	1,510	1,510
Other	10,031	—	10,031
Capital outlays	228,745	—	228,745
Total	<u>332,905</u>	<u>5,492</u>	<u>338,397</u>
Increase (decrease) in net assets before transfers	(12,312)	130	(12,182)
Transfers	40,142	15	40,157
Change in net assets	27,830	145	27,975
Net assets - July 1, 2001	627,651	42,026	669,677
Net assets - June 30, 2002	<u>\$ 655,481</u>	<u>\$ 42,171</u>	<u>\$ 697,652</u>

Analysis of Changes in Net Assets

The increase of \$27,974,755 in the Department's net assets is explained in the governmental and business-type activities discussion below, and is primarily a result of increased state allotments.

Governmental activities

Governmental activities increased the Department's net assets by \$27,829,501. The key element of this increase is the higher state allotments allocated to the Department.

A comparison of the cost of services by function of the Department's governmental activities is shown below, along with the revenues used to cover the net expenses of the governmental activities (amounts expressed in thousands):

	<u>Governmental Activities</u>
Expenses, net of program revenues:	
Administration and support	(2,431)
State procurement	(1,907)
Public building maintenance	(20,370)
Accounting	(2,277)
Audit	(1,661)
Performing and visual arts	(3,390)
School repairs and maintenance	(29,627)
Office leasing	(11,068)
Information processing services	(13,530)
Communications	(2,190)
Other	(1,329)
Capital outlays	(228,745)
Total expenses, net of program revenues	<u>(318,525)</u>
General revenues:	
State allotments, net of lapsed appropriations	305,377
Interest and investment earnings	783
Transfers	40,142
Other	53
Total general revenues	<u>346,355</u>
Increase in governmental activities net assets	<u>\$ 27,830</u>

Business-type activities

Business-type activities increased the Department's net assets by \$145,254 or 0.4%, during the current fiscal year. Key elements of this increase are as follows:

- The operations of the State Parking Revolving Fund resulted in a decrease in net assets of \$368,360.
- That decrease was offset by an increase in net assets of \$513,614 from the operations of the State Motor Pool Revolving Fund.

Key elements of the Department's business-type activities for the year ended June 30, 2002, are as follows (amounts expressed in thousands):

	Program Revenues			Expenses	Expenses Net of Program Revenues
	Charges for Services	Operating/ Capital Grants and Contributions	Total		
State Parking Revolving Fund	\$ 3,412	\$ —	\$ 3,412	\$ 3,982	\$ 570
State Motor Pool Revolving Fund	1,899	—	1,899	1,510	(389)
Total	\$ 5,311	\$ —	\$ 5,311	\$ 5,492	\$ 181

Financial Analysis of the Department's Individual Funds

As noted earlier, the Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the Department's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Department's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a Department's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Department's governmental funds reported combined ending fund balances of \$307,765,363, an increase of \$40,352,583 in comparison with the prior fiscal year. Approximately 0.63% of this total amount (\$1,945,139) constitutes unreserved fund balance, which is available for spending at the Department's discretion in the coming fiscal year. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate contracts and purchase orders of the prior period or are legally segregated for a specific future use (\$80,678,113), (2) for inventories (\$1,094,141), or (3) for encumbrances (\$224,047,970).

The General Fund is the chief operating fund of the Department. At the end of the current fiscal year, the General Fund had no unreserved fund balance, but total fund balance reached \$22,724,626. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 0% of total General Fund expenditures, while total fund balance represents 29.9% of that same amount.

The fund balance of the Department's General Fund decreased by \$2,494,938 during the current fiscal year due primarily to an increase in expenditures (\$1,562,133) and net transfers out and lapsed appropriations (\$4,352,961), which were offset by an increase in state allotments (\$4,014,699).

Proprietary Funds

The Department's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. At the end of the current fiscal year, the State Parking Revolving Fund had a decrease in net assets which amounted to \$368,360 and the State Motor Pool Revolving Fund had an increase in net assets which amounted to \$513,614. Other factors concerning the finances of the State Parking Revolving fund and the State Motor Pool Revolving Fund have already been addressed in the discussion of the Department's business-type activities.

Fiduciary Funds

The fiduciary funds of the Department consist of Agency Funds which are clearing accounts for funds held by the Department in its role as custodian until the funds are allocated to the individuals, businesses, and others to which they belong. These funds are excluded from the Department's government-wide financial statements because the Department cannot use these funds to finance its operations.

General Fund Budgetary Highlights

The General Fund's expenditure budget increased by approximately \$1.5 million from the original to the final budget. The original budget consists of the appropriations contained in the General Appropriations Act of 2001 (Act 259, Session Laws of Hawaii 2001) and the Supplemental Appropriations Act of 2002 (Act 177, Session Laws of Hawaii 2002). The original budget does not include collective bargaining allocations that were initially budgeted centrally to the State Department of Budget and Finance and later allocated to the various departments. A budget restriction of \$0.57 million was imposed on the Department which was met through savings in utility costs due to lower crude oil prices and restrictions to art program grants. The final budget reflects the collective bargaining allocations and budget restrictions.

Capital Asset and Debt Administration

Capital Assets

The Department's investment in capital assets for its governmental and business-type activities as of June 30, 2002 amounts to \$391,434,464 (net of accumulated depreciation).

This investment in capital assets includes land and improvements, historical treasures, works of art, buildings and improvements, equipment, furniture and fixtures, and motor vehicles. Major capital improvement projects, which received funding in the year ended June 30, 2002, included the following:

- \$2.0 million for an emergency generator for the Kalanimoku Building
- \$2.3 million for modernization of the shared state and federal microwave system
- \$3.3 million for the State Art Gallery

Additional information on the Department's capital assets can be found in Note 4 of the notes to basic financial statements.

Debt Administration

At the end of the current fiscal year, the Department had total bonded debt outstanding of \$2,226,411. This amount comprises debt backed by the full faith and credit of the State allocated to the State Parking Revolving Fund under acts of various Session Laws of Hawaii. Repayment of allocated bond debt is made to the State's General Fund. A breakdown of the Department's total bonded debt is shown below:

Long-Term Debt			
June 30, 2002 and 2001			
(Amounts in thousands)			
	Business-Type Activities		Total
	June 30, 2002	June 30, 2001	June 30, 2002
			June 30, 2001
General obligation bonds	2,226	2,709	2,226
			2,709
Total	\$ 2,226	\$ 2,709	\$ 2,226
			\$ 2,709

The Department's total debt decreased by \$482,745 (17.8%) during the current fiscal year. The key factor in this decrease was the repayments made to the State's General Fund on the allocated bond debt of the State Parking Revolving Fund.

The State's general obligation bonds have been rated by Moody's Investors Service (Aaa), by Standard & Poor's Corporation (AAA), and by Fitch IBCA, Inc. (AAA).

Additional information on the Department's long-term debt can be found in Note 7 of the notes to basic financial statements.

Economic Factors and Next Year's Budget

With the events of September 11, 2001, the State's General Fund tax revenues decreased 5.0% for the first ten months of 2002. To stimulate the economy, the State Legislature appropriated an additional \$75 million in capital improvement projects for school repairs and maintenance for a total budget of \$125 million for 2002. This trend continued and the State Legislature appropriated \$120 million for school repairs and maintenance for 2003.

Although the General Fund appropriations for the Department remained virtually unchanged between 2002 and 2003, in anticipation of lower than expected State General Fund tax revenues, the Governor imposed in late December 2002, a hiring freeze of non-essential vacant positions and a 5.0% reduction to discretionary funds for executive departments. This resulted in a \$2.8 million restriction to the Department for 2003. General funded budget reductions have also been submitted to amend the next biennium budget currently before the State Legislature. If adopted, these reductions will amount to \$1.7 million per year (or total \$3.4 million) in the biennium budget for the Department.

Requests for Information

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Comptroller, Department of Accounting and General Services, P.O. Box 119, Honolulu, Hawaii 96810-0119. General information about the Department can be found at the Department's website, <http://www.state.hi.us>.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Statement of Net Assets

June 30, 2002

	Primary Government			Component Unit
	Governmental Activities	Business-Type Activities	Total	
ASSETS:				
Current assets:				
Cash in state treasury	\$ 357,372,595	\$ 8,544,061	\$ 365,916,656	\$ 6,350,675
Receivables - net	-	313,737	313,737	422,224
Prepaid expenses	-	7,972	7,972	-
Inventories	1,094,141	10,967	1,105,108	-
Total current assets	358,466,736	8,876,737	367,343,473	6,772,899
Noncurrent assets:				
Capital assets - net of accumulated depreciation	355,305,184	36,129,280	391,434,464	53,524,826
Cash held by other state agency	-	-	-	704,697
Total noncurrent assets	355,305,184	36,129,280	391,434,464	54,229,523
Total assets	\$ 713,771,920	\$ 45,006,017	\$ 758,777,937	\$ 61,002,422

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Statement of Net Assets

June 30, 2002

	Primary Government			
	Governmental Activities	Business-Type Activities	Total	Component Unit
LIABILITIES:				
Current liabilities:				
Vouchers and contracts payable	\$ 38,598,849	\$ 100,234	\$ 38,699,083	\$ 166,403
Total current liabilities	38,598,849	100,234	38,699,083	166,403
Long-term liabilities:				
Due within one year:				
General obligation bonds payable	-	489,982	489,982	-
Accrued compensated absences	2,110,751	30,411	2,141,162	177,318
Accrued liabilities	-	102,274	102,274	339,486
Due in more than one year:				
General obligation bonds payable	-	1,736,429	1,736,429	-
Accrued compensated absences	5,479,260	199,791	5,679,051	251,193
Accrued liabilities	-	21,800	21,800	-
Due to State of Hawaii	-	140,962	140,962	30,000
Due to others	12,102,524	-	12,102,524	-
Deposits	-	13,310	13,310	66,300
Total long-term liabilities	19,692,535	2,734,959	22,427,494	864,297
Total liabilities	58,291,384	2,835,193	61,126,577	1,030,700
NET ASSETS:				
Invested in capital assets, net of related debt	355,305,184	33,902,869	389,208,053	94,101,239
Restricted for:				
Capital improvement projects	281,726,797	-	281,726,797	-
Other purposes	3,313,940	-	3,313,940	-
Unrestricted	15,134,615	8,267,955	23,402,570	(34,129,517)
Total net assets	\$ 655,480,536	\$ 42,170,824	\$ 697,651,360	\$ 59,971,722

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Statement of Activities

For the Year Ended June 30, 2002

FUNCTIONS/PROGRAMS	Program Revenues				Net (Expense) Revenue and Changes in Net Assets			
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government			Component Unit
					Governmental Activities	Business-Type Activities	Total	
Primary government:								
Governmental activities:								
Administration and support	\$ 2,430,497	\$ -	\$ -	\$ -	\$ (2,430,497)	\$ -	\$ (2,430,497)	
State procurement	1,907,064	-	-	-	(1,907,064)	-	(1,907,064)	
Public building maintenance	20,370,260	-	-	-	(20,370,260)	-	(20,370,260)	
Accounting	2,277,057	-	-	-	(2,277,057)	-	(2,277,057)	
Audit	1,660,724	-	-	-	(1,660,724)	-	(1,660,724)	
Performing and visual arts	3,920,417	-	529,918	-	(3,390,499)	-	(3,390,499)	
School repairs and maintenance	29,626,816	-	-	-	(29,626,816)	-	(29,626,816)	
Office leasing	16,215,803	5,147,530	-	-	(11,068,273)	-	(11,068,273)	
Information processing services	13,530,296	-	-	-	(13,530,296)	-	(13,530,296)	
Communications	2,190,101	-	-	-	(2,190,101)	-	(2,190,101)	
Other	10,031,256	8,702,308	-	-	(1,328,948)	-	(1,328,948)	
Capital outlays	228,745,114	-	-	-	(228,745,114)	-	(228,745,114)	
Total governmental activities	332,905,405	13,849,838	529,918	-	(318,525,649)	-	(318,525,649)	
Business-type activities:								
State Parking Revolving Fund	3,982,200	3,411,644	-	-	-	(570,556)	(570,556)	
State Motor Pool Revolving Fund	1,509,658	1,899,255	-	-	-	389,597	389,597	
Total business-type activities	5,491,858	5,310,899	-	-	-	(180,959)	(180,959)	
Total primary government	338,397,263	19,160,737	529,918	-	(318,525,649)	(180,959)	(318,706,608)	
Component unit:								
Stadium Authority	9,856,686	7,264,018	-	-				\$ (2,592,668)
General revenues:								
State allotments, net of lapsed appropriations of \$7,241,065					305,377,249	-	305,377,249	-
Interest and investment income					782,981	311,332	1,094,313	226,320
Other					52,987	-	52,987	2,527,394
Transfers					40,141,933	14,881	40,156,814	-
Total general revenues and transfers					346,355,150	326,213	346,681,363	2,753,714
Change in net assets					27,829,501	145,254	27,974,755	161,046
Net assets - beginning					627,651,035	42,025,570	669,676,605	59,810,676
Net assets - ending					\$ 655,480,536	\$ 42,170,824	\$ 697,651,360	\$ 59,971,722

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Balance Sheet - Governmental Funds

June 30, 2002

	General Fund	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
ASSETS:				
Cash in state treasury	\$ 25,028,133	\$ 316,594,469	\$ 15,749,993	\$ 357,372,595
Inventories	1,094,141	-	-	1,094,141
Total assets	<u>\$ 26,122,274</u>	<u>\$ 316,594,469</u>	<u>\$ 15,749,993</u>	<u>\$ 358,466,736</u>
LIABILITIES AND FUND BALANCES:				
Liabilities:				
Vouchers and contracts payable	\$ 3,397,648	\$ 34,867,672	\$ 333,529	\$ 38,598,849
Due to others	-	-	12,102,524	12,102,524
Total liabilities	<u>3,397,648</u>	<u>34,867,672</u>	<u>12,436,053</u>	<u>50,701,373</u>
Fund balances:				
Reserved for encumbrances	21,630,485	201,164,255	1,253,230	224,047,970
Reserved for inventories	1,094,141	-	-	1,094,141
Reserved for continuing appropriations	-	80,562,542	115,571	80,678,113
Unreserved	-	-	1,945,139	1,945,139
Total fund balances	<u>22,724,626</u>	<u>281,726,797</u>	<u>3,313,940</u>	<u>307,765,363</u>
Total liabilities and fund balances	<u>\$ 26,122,274</u>	<u>\$ 316,594,469</u>	<u>\$ 15,749,993</u>	<u>\$ 358,466,736</u>

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets

June 30, 2002

Total fund balance - governmental funds \$ 307,765,363

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. Those assets consist of :

Land	88,404,189	
Historical treasures and works of art	39,485,283	
Buildings and improvements	400,975,314	
Equipment, furniture and fixtures	18,693,747	
Accumulated depreciation	<u>(192,253,349)</u>	
		355,305,184

Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:

Accrued vacation payable	<u>(7,590,011)</u>	<u>(7,590,011)</u>
--------------------------	--------------------	--------------------

Net assets of governmental activities	<u><u>\$ 655,480,536</u></u>
---------------------------------------	------------------------------

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds

For the Year Ended June 30, 2002

	General Fund	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
Revenues:				
State allotments	\$ 78,339,825	\$ 233,368,697	\$ 909,792	\$ 312,618,314
Insurance	-	-	7,737,856	7,737,856
Rentals	-	-	4,920,931	4,920,931
Interest and investment income	-	-	782,981	782,981
Intergovernmental	-	-	529,918	529,918
Other	-	-	1,244,038	1,244,038
Total revenues	<u>78,339,825</u>	<u>233,368,697</u>	<u>16,125,516</u>	<u>327,834,038</u>
Expenditures:				
Administration and support	2,299,685	-	43,703	2,343,388
State procurement	939,215	-	941,987	1,881,202
Public building maintenance	14,330,065	-	-	14,330,065
Accounting	2,214,837	-	-	2,214,837
Audit	1,648,255	-	-	1,648,255
Performing and visual arts	1,947,348	-	1,952,201	3,899,549
School repairs and maintenance	23,515,225	-	-	23,515,225
Office leasing	11,052,660	-	5,159,903	16,212,563
Information processing services	12,775,778	-	-	12,775,778
Communications	2,184,397	-	-	2,184,397
Other	3,160,383	-	6,888,263	10,048,646
Capital outlays	-	228,914,464	-	228,914,464
Total expenditures	<u>76,067,848</u>	<u>228,914,464</u>	<u>14,986,057</u>	<u>319,968,369</u>
Excess of revenues over expenditures	<u>2,271,977</u>	<u>4,454,233</u>	<u>1,139,459</u>	<u>7,865,669</u>
Other financing sources (uses):				
Transfers in (out)	(1,247,882)	38,439,971	2,949,844	40,141,933
Lapsed appropriations	(3,105,079)	-	(4,135,986)	(7,241,065)
Decrease in reserve for inventories	(413,954)	-	-	(413,954)
Total other financing sources (uses), net	<u>(4,766,915)</u>	<u>38,439,971</u>	<u>(1,186,142)</u>	<u>32,486,914</u>
Net change in fund balances	(2,494,938)	42,894,204	(46,683)	40,352,583
Fund balances - beginning	<u>25,219,564</u>	<u>238,832,593</u>	<u>3,360,623</u>	<u>267,412,780</u>
Fund balances - ending	<u>\$ 22,724,626</u>	<u>\$ 281,726,797</u>	<u>\$ 3,313,940</u>	<u>\$ 307,765,363</u>

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Reconciliation of the Governmental Funds Statement of Revenues,
Expenditures, and Changes in Fund Balances to the Statement of Activities

For the Year Ended June 30, 2002

Total net change in fund balances - governmental funds \$ 40,352,583

Amounts reported for governmental activities in the statement of activities are different because:

Capital outlays are reported as expenditures in governmental funds; however, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, those amounts were:

Capital outlays	\$ 169,350	
Depreciation expense	<u>(12,184,757)</u>	
Excess of depreciation expense over capital outlays		(12,015,407)

The increase in accrued vacation is reported in the statement of activities, but does not require the use of current financial resources and therefore is not reported as an expenditure in governmental funds.

(507,675)

Change in net assets of governmental activities

\$ 27,829,501

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Statement of Revenues, Expenditures , and Changes In Fund Balances -
Budget and Actual (Budgetary Basis) - General Fund

For the Year Ended June 30, 2002

	Original Budget	Final Budget	Actual (Budgetary Basis)	Variance - Favorable (Unfavorable)
Revenues	\$ 78,339,825	\$ 78,339,825	\$ 78,339,825	\$ -
Expenditures:				
Administration and support	2,218,750	2,519,042	2,495,862	23,180
State procurement	971,234	967,100	962,631	4,469
Public building maintenance	16,116,181	15,444,745	15,437,560	7,185
Accounting	2,197,001	2,333,116	2,332,597	519
Audit	1,291,995	1,944,178	1,939,271	4,907
Performing and visual arts	2,281,143	2,077,060	2,061,788	15,272
School repairs and maintenance	23,259,540	24,097,634	24,066,209	31,425
Office leasing	12,822,611	12,727,928	12,727,912	16
Information processing services	12,183,401	12,638,553	12,620,816	17,737
Communications	2,116,267	2,143,874	2,127,396	16,478
Other	2,881,702	3,006,290	2,993,454	12,836
Total expenditures	78,339,825	79,899,520	79,765,496	134,024
Deficiency of revenues over expenditures	\$ -	\$ (1,559,695)	\$ (1,425,671)	\$ (134,024)

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Statement of Net Assets - Proprietary Funds

June 30, 2002

	State Parking Revolving Fund	State Motor Pool Revolving Fund	Total Proprietary Funds
ASSETS:			
Current assets:			
Cash in state treasury	\$ 5,634,558	\$ 2,909,503	\$ 8,544,061
Accounts receivable - net	137,241	176,423	313,664
Due from other funds	14,298	8,115	22,413
Prepaid expenses	7,972	-	7,972
Inventories	4,662	6,305	10,967
Total current assets	<u>5,798,731</u>	<u>3,100,346</u>	<u>8,899,077</u>
Noncurrent assets:			
Capital assets - net of accumulated depreciation	<u>33,953,241</u>	<u>2,176,039</u>	<u>36,129,280</u>
Total assets	<u>\$ 39,751,972</u>	<u>\$ 5,276,385</u>	<u>\$ 45,028,357</u>
LIABILITIES:			
Current liabilities:			
Accounts payable	\$ 82,203	\$ 18,031	\$ 100,234
Accrued liabilities	102,680	30,005	132,685
Due to other funds	8,042	14,298	22,340
General obligation bonds payable	489,982	-	489,982
Total current liabilities	<u>682,907</u>	<u>62,334</u>	<u>745,241</u>
Noncurrent liabilities:			
Accrued liabilities	132,838	88,753	221,591
Due to State of Hawaii	140,962	-	140,962
Deposits	13,310	-	13,310
General obligation bonds payable	1,736,429	-	1,736,429
Total noncurrent liabilities	<u>2,023,539</u>	<u>88,753</u>	<u>2,112,292</u>
Total liabilities	<u>2,706,446</u>	<u>151,087</u>	<u>2,857,533</u>
NET ASSETS:			
Investment in capital assets, net of related debt	31,726,830	2,176,039	33,902,869
Unrestricted	<u>5,318,696</u>	<u>2,949,259</u>	<u>8,267,955</u>
Total net assets	<u>\$ 37,045,526</u>	<u>\$ 5,125,298</u>	<u>\$ 42,170,824</u>

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Statement of Revenues, Expenses, and Changes in Fund Net Assets - Proprietary Funds

For the Year Ended June 30, 2002

	State Parking Revolving Fund	State Motor Pool Revolving Fund	Total Proprietary Funds
Operating revenues:			
Parking assessments	\$ 2,441,392	\$ -	\$ 2,441,392
Motor vehicle rentals	-	1,684,300	1,684,300
Parking meter collections	736,769	-	736,769
Traffic fines	233,327	-	233,327
Motor vehicle repairs	-	214,955	214,955
Other income	156	-	156
Total operating revenues	<u>3,411,644</u>	<u>1,899,255</u>	<u>5,310,899</u>
Operating expenses:			
Personnel services	877,274	459,510	1,336,784
Depreciation	1,671,521	516,299	2,187,820
Gas and oil	-	237,505	237,505
Repairs and maintenance	843,790	134,600	978,390
Special assessments	55,479	55,336	110,815
Other	382,569	100,853	483,422
Total operating expenses	<u>3,830,633</u>	<u>1,504,103</u>	<u>5,334,736</u>
Operating income (loss)	(418,989)	395,152	(23,837)
Nonoperating revenues (expenses):			
Interest income	202,196	109,136	311,332
Interest expense	(126,682)	-	(126,682)
Assessment on ceded land revenues	(24,885)	-	(24,885)
Loss on disposition of capital assets	-	(5,555)	(5,555)
Total nonoperating revenues - net	<u>50,629</u>	<u>103,581</u>	<u>154,210</u>
Change in net assets before transfers	(368,360)	498,733	130,373
Transfers	-	14,881	14,881
Change in net assets	(368,360)	513,614	145,254
Net assets - beginning	<u>37,413,886</u>	<u>4,611,684</u>	<u>42,025,570</u>
Net assets - ending	<u>\$ 37,045,526</u>	<u>\$ 5,125,298</u>	<u>\$ 42,170,824</u>

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Statement of Cash Flows - Proprietary Funds

For the Year Ended June 30, 2002

	State Parking Revolving Fund	State Motor Pool Revolving Fund	Total Proprietary Funds
CASH FLOWS FROM OPERATING ACTIVITIES:			
Receipts from parking assessments	\$ 2,452,052	\$ -	\$ 2,452,052
Receipts from motor vehicle rentals	-	1,725,802	1,725,802
Receipts from parking meter collections	735,681	-	735,681
Receipts from motor vehicle repairs	-	214,955	214,955
Receipts from traffic fines	233,327	-	233,327
Other receipts	156	50	206
Payments for personnel services	(852,106)	(449,221)	(1,301,327)
Payments for gas and oil	-	(237,505)	(237,505)
Payments for repairs and maintenance	(843,790)	(134,600)	(978,390)
Payments for special assessment	(47,437)	(63,451)	(110,888)
Other payments	(345,876)	(124,892)	(470,768)
Net cash provided by operating activities	<u>1,332,007</u>	<u>931,138</u>	<u>2,263,145</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Interest from investments	202,196	109,087	311,283
Net cash provided by investing activities	<u>202,196</u>	<u>109,087</u>	<u>311,283</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:			
Payments for construction in progress, net of completed repairs	9,112	-	9,112
Ceded land payment	(24,104)	-	(24,104)
Acquisition of capital assets	(16,096)	(976,902)	(992,998)
Proceeds from disposal of capital assets	-	81,949	81,949
Principal paid on general obligation bonds	(482,745)	-	(482,745)
Interest paid on general obligation bonds	(137,132)	-	(137,132)
Net cash used in capital and related financing activities	<u>(650,965)</u>	<u>(894,953)</u>	<u>(1,545,918)</u>
Net increase in cash and cash equivalents	883,238	145,272	1,028,510
Cash and cash equivalents - beginning	<u>4,751,320</u>	<u>2,764,231</u>	<u>7,515,551</u>
Cash and cash equivalents - ending	<u>\$ 5,634,558</u>	<u>\$ 2,909,503</u>	<u>\$ 8,544,061</u>

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Statement of Cash Flows - Proprietary Funds

For the Year Ended June 30, 2002

	State Parking Revolving Fund	State Motor Pool Revolving Fund	Total Proprietary Funds
RECONCILIATION OF INCOME (LOSS) FROM OPERATIONS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:			
Income (loss) from operations	\$ (418,989)	\$ 395,152	\$ (23,837)
Adjustments to reconcile income (loss) from operations to net cash provided by operating activities:			
Depreciation	1,671,521	516,299	2,187,820
Miscellaneous income	-	50	50
(Increase) decrease in assets:			
Accounts receivable	17,544	41,502	59,046
Prepaid special assessment	(7,972)	-	(7,972)
Due from other funds	(4,585)	(8,115)	(12,700)
Inventories	2,395	4,958	7,353
Increase (decrease) in liabilities:			
Accounts payable	34,423	(33,582)	841
Accrued wages payable	2,890	(2,236)	654
Accrued vacation payable	22,278	12,525	34,803
Security card deposits	4,460	-	4,460
Due to other funds	8,042	4,585	12,627
Net cash provided by operating activities	<u>\$ 1,332,007</u>	<u>\$ 931,138</u>	<u>\$ 2,263,145</u>

The accompanying notes are an integral part of the basic financial statements.

State of Hawaii
Department of Accounting and General Services
Statement of Fiduciary Net Assets - Fiduciary Funds

June 30, 2002

	<u>Agency Funds</u>
ASSETS:	
Cash in state treasury	<u>\$ 9,781,653</u>
Total assets	<u><u>\$ 9,781,653</u></u>
LIABILITIES:	
Due to individuals, businesses, and others	<u>\$ 9,781,653</u>
Total liabilities	<u><u>\$ 9,781,653</u></u>

The accompanying notes are an integral part of the basic financial statements.

STATE OF HAWAII

DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

NOTES TO BASIC FINANCIAL STATEMENTS

JUNE 30, 2002

1. Financial Statement Presentation

The accompanying basic financial statements of the Department of Accounting and General Services (Department), State of Hawaii (State), have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) for state and local governments as prescribed by the Governmental Accounting Standards Board (GASB).

Reporting Entity

The Department was created in 1959 by the Hawaii State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawaii 1959). The primary function of the Department is to provide professional and technical expertise to state agencies and to enforce compliance with accounting and internal control systems.

The Department has defined its financial reporting entity in accordance with GASB Statement No. 14, *The Financial Reporting Entity*. This statement establishes standards for defining and reporting on the financial reporting entity. The basic criterion for including a potential component unit within the financial reporting entity is financial accountability. Other criteria include legal standing and fiscal dependency.

Based on the application of these criteria, the Department's financial reporting entity consists of the Department and the Stadium Authority, a component unit of the State that is administratively attached to the Department.

The accompanying basic financial statements present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually, which includes the Department's financial activities.

The GASB issued GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*. These pronouncements establish new financial reporting requirements and a new financial reporting model for state and local governments. The Department adopted these pronouncements effective July 1, 2001. The following describes the more significant changes for the Department.

Management's Discussion and Analysis

GASB Statement No. 34 requires that the basic financial statements be accompanied by a narrative introduction and analytical overview of the Department's financial activities in the form of "management's discussion and analysis" (MD&A). This analysis is similar to the analysis the private sector provides in the annual reports of publicly traded companies.

Government-Wide and Fund Financial Statements

The basic financial statements include both government-wide (based on the Department as a whole) and fund financial statements. While the previous reporting model emphasized fund types (the total of all funds of a particular type), the focus in the new reporting model is on either the Department as a whole or major individual funds (within the fund financial statements).

The new reporting model includes a statement of net assets and a statement of activities prepared using full accrual accounting for all of the Department's activities. This approach includes not just current assets and liabilities (such as cash and accounts payable) but also capital assets and long-term liabilities (such as buildings and accrued vacation payable). Accrual accounting also reports all of the revenues and cost of providing services each year, not just those received or paid in the current year or soon thereafter.

Statement of Net Assets

The statement of net assets is designed to display the financial position of the Department. The Department reports all capital assets in the statement of net assets and reports depreciation expense in the statement of activities. The net assets are reported in three categories: (1) invested in capital assets, net of related debt; (2) restricted; and (3) unrestricted.

Statement of Activities

The statement of activities reports expenses and revenues in a format that focuses on the cost of each of the Department's functions. The expense of individual functions is compared to the revenues generated directly by the function (for instance, through user charges or intergovernmental grants).

The Department uses funds to report on its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain departmental functions or activities.

A fund is a separate accounting entity with a self-balancing set of accounts. Government resources are allocated to, and accounted for, in individual funds based upon the purpose for which the resources are to be spent and the means by which spending activities are controlled. The Department uses three fund type categories: governmental, proprietary and fiduciary. Each category, in turn, is divided into separate "fund types":

Governmental Funds

The Department has the following major funds:

General Fund

The General Fund is the operating fund of the Department. It is used to account for all financial resources except those required to be accounted for in another fund.

Capital Projects Fund

The Capital Projects Fund is used to account for the Department's construction projects and the related sources of financing (other than those financed by the proprietary fund types).

The nonmajor governmental funds are comprised of Special Revenue Funds which are used to account for the financial resources obtained from specific revenue sources and used for restricted purposes (other than expendable trusts or capital projects).

Proprietary Funds

The Department uses proprietary funds to account for certain of the Department's ongoing operations. The measurement focus is upon determination of net income. The following are the Department's proprietary fund types:

Enterprise Fund

The Enterprise Fund is used to account for an operation that is financed and operated in a manner similar to a private business enterprise, where the intent is that the costs of providing services are to be financed or recovered primarily through user charges. The Department's Enterprise Fund consists of the State Parking Revolving Fund.

Internal Service Fund

The Internal Service Fund is used to account for the recovery of the costs of vehicles through rental charges to other state agencies. The Department's Internal Service Fund consists of the State Motor Pool Revolving Fund.

Fiduciary Funds

Agency Funds are used to account for the receipt and disbursement of cash by the Department in a custodial capacity.

Component Unit

The Stadium Authority's operations are reported as an Enterprise Fund which is described under the proprietary fund types.

2. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting

The government-wide statement of net assets is reflected on a full accrual, economic resource basis, which incorporates long-term assets and receivables as well as long-term debt and obligations.

The government-wide statement of activities reflects both the gross and net cost per functional category which are otherwise being supported by general government revenues. The statement of activities reduces gross expenses (including depreciation) by related program revenues, operating and capital grants, and contributions (if any). The program revenues must be directly associated with the function. The Department does not allocate indirect expenses.

The financial statements of the proprietary funds and component unit are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide financial statements described above.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Department has elected not to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The Department's fiduciary funds are presented in the fund financial statements. Since by definition these assets are being held for the benefit of a third party and cannot be used to address activities or obligations of the Department, these funds are not incorporated into the government-wide financial statements.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

The modified accrual basis of accounting is used by all governmental fund types and the Agency Funds. Under the modified accrual basis of accounting, revenues such as interest are recognized when susceptible to accrual (i.e., when they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at year-end).

Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after year-end to liquidate liabilities existing at the end of the fiscal year. The Department considers receivables collected within 60 days after year-end to be available and recognizes them as revenues of the current fiscal year. Expenditures are recorded when the related fund liability is incurred.

The Department reports deferred revenues on its statement of net assets/balance sheet. Deferred revenues arise when both the “measurable” and “available” criteria for recognition are not met in the current period. Deferred revenues also arise when the Department receives resources before it has a legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the Department has a legal claim to the resources, the liability for the deferred revenue is removed from the statement of net assets/balance sheet and revenue is recognized.

Encumbrances represent commitments related to unperformed contracts for goods or services. Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of resources are recorded to reserve that portion of the applicable appropriation, is utilized in the governmental funds. Encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will generally be honored during the subsequent fiscal year.

Cash and Short-Term Investments

The State maintains a cash pool that is available for all funds. Each fund type’s portion of this cash pool is presented on the statement of net assets/balance sheet. Those funds are pooled with funds from other state agencies and departments and deposited in approved financial institutions by the State Director of Finance. Deposits not covered by federal deposit insurance are fully collateralized by government securities held in the name of the State by third-party custodians.

The Hawaii Revised Statutes (HRS) authorize the State Director of Finance to invest in obligations of or guaranteed by the U.S. government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions.

For purposes of the statement of cash flows, all highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

Inventories

Inventories of supplies and materials are stated at the lower of cost (first-in, first-out method) or market and are recorded as expenditures when purchased.

Capital Assets

Capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital asset acquisition and construction are reflected as expenditures in the governmental funds, and the related assets are reported in the statement of net assets. Capital assets acquired by purchase are recorded at cost. Donated capital assets are valued at the estimated fair market value on the date received. Maintenance, repairs, minor replacements, renewals, and betterments are charged to operations as incurred. Major replacements, renewals, and betterments are capitalized. Capital assets are depreciated on the straight-line method over their estimated useful lives as follows:

	<u>Estimated Useful Lives</u>	<u>Capitalization Threshold</u>
Buildings and improvements	30 years	\$100,000
Equipment	5-12 years	\$5,000
Furniture and fixtures	5-12 years	\$5,000
Motor vehicles	10 years	\$5,000

Nonexchange Transactions

Effective July 1, 2000, the Department adopted GASB Statement No.33, *Accounting and Financial Reporting for Nonexchange Transactions*, which requires the Department to record grant revenue only when all eligibility requirements have been met and amounts are available.

Intrafund and Interfund Transactions

Transfers of financial resources within the same fund are eliminated. Transfers from funds receiving revenues to funds through which the resources are to be expended are recorded as operating transfers. Nonrecurring or nonroutine transfers of equity between funds are recorded as residual equity transfers.

Use of Estimates

The preparation of basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenues, expenditures, and other financing sources and uses during the reporting period. Actual results could differ from those estimates.

Delegated Funds

Funds delegated to the Department by other state agencies for the purpose of administering various projects are accounted for in the Agency Funds of the fiduciary fund type.

Employee Benefit Costs

Costs for pension, health, social security and workers' compensation benefits for governmental funds are recorded by the funds budgeted to make the expenditure. Costs applicable to the General Fund are not charged to the Department by the State whereas costs applicable to the Special Revenue Funds and Capital Projects Fund are reflected as expenditures in the respective fund. Costs applicable to the proprietary fund types are reflected as expenses in the Enterprise Fund and the Internal Service Fund.

3. Reconciliation To Budgetary Reporting

The budget of the Department is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. The budget includes (1) the programs, services, and activities to be provided during the fiscal year, (2) the estimated revenues available to finance the operating plan, and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented, and controlled.

Revenue estimates are provided to the State Legislature at the time of budget consideration and are

revised and updated periodically during the year. Amounts reflected as budgeted revenues in the statement of revenues and expenditures - budget and actual (budgetary basis) - general fund are those estimates as compiled and reviewed by the Department. Budgeted expenditures are derived primarily from acts of the State Legislature and from other authorizations contained in the State Constitution, the HRS and other specific appropriations acts in various Session Laws of Hawaii.

All expenditures of these appropriated funds are made pursuant to the appropriations in the General Appropriations Act of 2001 (Act 259, Session Laws of Hawaii 2001), as amended by the Supplemental Appropriations Act of 2002 (Act 177, Session Laws of Hawaii 2002).

The General Fund has legally appropriated annual budgets; the Capital Projects Fund's appropriated budgets are for projects that may extend over several fiscal years.

The final legally adopted budget in the accompanying statement of revenues and expenditures - budget and actual (budgetary basis) - general fund represents the original appropriations, transfers, and other legally authorized legislative and executive changes.

The legal level of budgetary control is maintained at the appropriation line item level by department, program, and source of funds as established in the appropriations act. The Governor is authorized to transfer appropriations between programs within the same department and source of funds; however, transfers of appropriations between departments generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the Department. During the year ended June 30, 2002, there were no expenditures in excess of appropriations at the legal level of budgetary control.

To the extent not expended or encumbered, the General Fund's appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other contingencies which may terminate the authorization for other appropriations.

The budgets adopted by the State Legislature for the General Fund are presented in the accompanying statement of revenues and expenditures - budget and actual (budgetary basis) - general fund. The Department's annual budget is prepared on the modified accrual basis of accounting with several differences from the preparation of the statement of revenues, expenditures, and changes in fund balances, principally related to (1) encumbrance of purchase orders and contract obligations, (2) accrued revenues and expenditures, and (3) unbudgeted programs (federal award programs). The first two differences represent departures from GAAP.

A reconciliation of the budgetary to GAAP basis operating results for the year ended June 30, 2002 follows:

	<u>General Fund</u>
Excess of expenditures over revenues - non-GAAP budgetary actual	\$ (1,425,671)
Reserve for encumbrances at year-end, net of encumbrances relating to prior years' appropriations	16,192,691
Expenditures for liquidation of prior years' encumbrances, net of lapsed allotments	<u>(12,495,043)</u>
Excess of revenues over expenditures - GAAP actual	<u><u>\$ 2,271,977</u></u>

4. Capital Assets

For the year ended June 30, 2002, capital assets activity for the governmental activities and business-type activities were as follows:

Primary Government	Governmental Activities			
	Restated Balance July 1, 2001 Note (9)	Additions	Deductions	Balance June 30, 2002
Capital assets not being depreciated:				
Land and improvements	\$ 88,404,189	\$ -	\$ -	\$ 88,404,189
Historical treasures	24,504,658	-	-	24,504,658
Works of art	14,940,406	40,219	-	14,980,625
Total capital assets not being depreciated	127,849,253	40,219	-	127,889,472
Capital assets being depreciated:				
Buildings and improvements	400,975,314	-	-	400,975,314
Equipment, furniture and fixtures	14,613,787	60,506	-	14,674,293
Motor vehicles	3,950,829	68,625	-	4,019,454
Total capital assets being depreciated	419,539,930	129,131	-	419,669,061
Total capital assets	547,389,183	169,350	-	547,558,533
Less accumulated depreciation for:				
Buildings and improvements	(162,926,142)	(11,892,432)	-	(174,818,574)
Equipment, furniture and fixtures	(13,398,820)	(236,192)	-	(13,635,012)
Motor vehicles	(3,743,630)	(56,133)	-	(3,799,763)
Total accumulated depreciation	(180,068,592)	(12,184,757)	-	(192,253,349)
Total capital assets - net	\$ 367,320,591	\$ (12,015,407)	\$ -	\$ 355,305,184

The accumulated depreciation balances at July 1, 2001 were restated to record accumulated depreciation in accordance with the adoption of GASB Statement No. 34. The gross cost balances at July 1, 2001 were also restated to reflect an increase in the Department's capitalization threshold from \$1,000 to \$5,000 (historical treasures, works of art, furniture and equipment and motor vehicles) and \$100,000 (land improvements and buildings). Balances as of July 1, 2001 were restated as follows:

	Balance July 1, 2001	Restatement	Restated Balance July 1, 2001
Capital assets not being depreciated:			
Land and improvements	\$ 93,373,974	\$ (4,969,785)	\$ 88,404,189
Historical treasures	29,133,220	(4,628,562)	24,504,658
Works of art	18,903,652	(3,963,246)	14,940,406
Total capital assets not being depreciated	141,410,846	(13,561,593)	127,849,253
Capital assets being depreciated:			
Buildings and improvements	237,816,455	163,158,859	400,975,314
Equipment, furniture and fixtures	25,723,946	(11,110,159)	14,613,787
Motor vehicles	25,660	3,925,169	3,950,829
Total capital assets being depreciated	263,566,061	155,973,869	419,539,930
Total capital assets	404,976,907	142,412,276	547,389,183
Less accumulated depreciation for:			
Buildings and improvements	-	(162,926,142)	(162,926,142)
Equipment, furniture and fixtures	-	(13,398,820)	(13,398,820)
Motor vehicles	-	(3,743,630)	(3,743,630)
Total accumulated depreciation	-	(180,068,592)	(180,068,592)
Total capital assets - net	\$ 404,976,907	\$ (37,656,316)	\$ 367,320,591

	Business-Type Activities		
	Balance July 1, 2001	Additions	Balance June 30, 2002
Capital assets not being depreciated:			
Land and improvements	\$ 10,271,053	\$ -	\$ 10,271,053
Construction in progress	46,509	204,142	37,397
Total capital assets not being depreciated	10,317,562	204,142	10,308,450
Capital assets being depreciated:			
Buildings and improvements	54,162,305	-	54,162,305
Equipment, furniture and fixtures	120,717	24,592	145,309
Motor vehicles	3,584,229	1,027,089	4,200,973
Total capital assets being depreciated	57,867,251	1,051,681	58,508,587
Total capital assets	68,184,813	1,255,823	68,817,037
Less accumulated depreciation for:			
Buildings and improvements	(28,899,536)	(1,661,719)	(30,561,255)
Equipment, furniture and fixtures	(82,524)	(10,794)	(93,318)
Motor vehicles	(1,796,914)	(514,805)	(2,033,184)
Total accumulated depreciation	(30,778,974)	(2,187,318)	(32,687,757)
Total capital assets - net	\$ 37,405,839	\$ (931,495)	\$ 36,129,280

Depreciation expense was charged to functions of the Department as follows:

Governmental activities:	
Administration and support	\$ 29,260
State procurement	2,262
Public building maintenance	5,929,841
Accounting	7,396
Audit	-
Performing and visual arts	1,947
School repairs and maintenance	6,013,877
Office leasing	-
Information processing services	181,830
Communications	-
Other	18,344
Total depreciation expense - governmental activities	<u>\$ 12,184,757</u>
Business-type activities:	
Parking control	\$ 1,671,521
Motor pool	516,299
Total depreciation expense - business-type activities	<u>\$ 2,187,820</u>

Component Unit

	Stadium Authority		
	Balance July 1, 2001	Additions	Balance June 30, 2002
Capital assets not being depreciated:			
Land and improvements	\$ 11,518,621	\$ -	\$ 11,518,621
Total capital assets not being depreciated	11,518,621	-	11,518,621
Capital assets being depreciated:			
Stadium structure	90,571,260	-	90,571,260
Equipment, furniture and fixtures	7,720,633	432,917	8,153,550
Total capital assets being depreciated	98,291,893	432,917	98,724,810
Total capital assets	109,810,514	432,917	110,243,431
Less accumulated depreciation for:			
Stadium structure	(47,351,136)	(3,395,665)	(50,746,801)
Equipment, furniture and fixtures	(5,542,516)	(429,288)	(5,971,804)
Total accumulated depreciation	(52,893,652)	(3,824,953)	(56,718,605)
Total capital assets - net	\$ 56,916,862	\$ (3,392,036)	\$ 53,524,826

5. Accrued Vacation

Changes in accrued vacation payable during the year ended June 30, 2002 were as follows:

	Primary Government			Component Unit
	Governmental Activities	Business-Type Activities	Total	
Balance, July 1, 2001	\$ 7,082,336	\$ 195,400	\$ 7,277,736	\$ 428,237
Net increase in accrued vacation payable	507,675	34,802	542,477	274
Balance, June 30, 2002	\$ 7,590,011	\$ 230,202	\$ 7,820,213	\$ 428,511

6. Retirement Benefits

Retirement Plan

All eligible employees of the State and counties are required by HRS Chapter 88 to become members of the ERS, a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a Comprehensive Annual Financial Report (CAFR) that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under social security. Police officers, firefighters, judges, elected officials and persons employed in positions not covered by social security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively.

Both options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

Most covered employees of the contributory option are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the departments of the County Prosecuting Attorney and the State Attorney General, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over the remaining period of 19 years from July 1, 1997.

The Department is required to contribute to both the contributory and noncontributory options at an actuarially determined rate. Changes in salary growth assumptions and investment earnings pursuant to Act 100, Session Laws of Hawaii 1999, resulted in no required contributions for the years ended June 30, 2002, 2001, and 2000.

Post-Retirement Health Care and Insurance Benefits

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87, provides certain health care and life insurance benefits to all qualified employees. For employees hired before July 1, 1996, the State pays the entire monthly health care premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than 10 years of credited service. For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the State pays the entire health care premium.

There are currently 22,500 state retirants receiving such benefits. Free life insurance coverage for retirants and free dental coverage for dependents under age 19 are also available. Retirants covered by the medical portion of Medicare are eligible to receive a partial reimbursement of the basic medical coverage premium. Contributions are financed on a pay-as-you-go basis. During fiscal 2002, post-retirement benefits expense of \$59,514 was recognized in the proprietary funds' financial statements. The post-retirement benefits expense of the component unit has not been separately computed and is not reflected in the component unit's financial statements.

7. Long-Term Debt

Long-term debt consists of bond debts allocated to the State Parking Revolving Fund under acts of various Session Laws of Hawaii. Repayment of allocated bond debts are made to the State's General Fund. Details of allocated bond debts at June 30, 2002 are as follows:

5.15% - 6.40% General obligation bonds, Series BW, of \$20,800 issued in March 1992 under Act 300, Session Laws of Hawaii 1995; annual principal payments of \$1,156 beginning March 1, 1995 through March 1, 1996, and \$1,155 beginning March 1, 1997 through March 1, 2012; semi-annual interest payments due September 1 and March 1; maturing in March 2012	\$ 11,554
4.30% - 5.75% General obligation refunding bonds, Series CB, of \$2,884,269 issued in January 1993 under Act 315, Session Laws of Hawaii 1992; annual principal payments of \$221,980 beginning January 1, 1996 through January 1, 1997, and \$221,846 beginning January 1, 1998 through January 1, 2008; semi-annual interest payments due July 1 and January 1; maturing in January 2008	1,331,078
3.85% - 7.75% General obligation refunding bonds, Series CC, of \$218,603 issued in February 1993 under Act 315, Session Laws of Hawaii 1992; annual principal payments of \$15,615 beginning February 1, 1996 through February 1, 2005, and \$15,612 beginning February 1, 2006 through February 1, 2009; semi-annual interest payments due August 1 and February 1; maturing in February 2009	109,295
3.85% - 5.00% General obligation refunding bonds, Series CD, of \$490,273 issued in February 1993 under Act 315, Session Laws of Hawaii 1992; annual principal payments of \$61,295 beginning February 1, 1996 through February 1, 1998, and \$61,278 beginning February 1, 1999 through February 1, 2003; semi-annual interest payments due August 1 and February 1; maturing in February 2003	61,278
3.25% - 5.50% General obligation refunding bonds, Series CF, of \$473,173 issued in July 1993 under Act 315, Session Laws of Hawaii 1992; annual principal payments of \$52,587 beginning July 1, 1994 through July 1, 1995, and \$52,571 beginning July 1, 1996 through July 1, 2002; semi-annual interest payments due January 1 and July 1; maturing in July 2002	52,571
Subtotal carried forward	<hr/> \$ 1,565,776

Subtotal brought forward

\$ 1,565,776

4.00% - 5.00% General obligation refunding bonds, Series CI, of \$550,212 issued in October 1993 under Act 344, Session Laws of Hawaii 1993; annual principal payments of \$36,685 beginning November 1, 1996 through November 1, 2003, and \$36,676 beginning November 1, 2004 through November 1, 2010; semi-annual interest payments due November 1 and May 1; maturing in November 2010

330,103

4.00% - 5.00% General obligation refunding bonds, Series CQ, of \$659,806 issued in October 1997 under Act 357, Session Laws of Hawaii 1997; annual principal payments of \$81,623 beginning October 1, 1998 and increasing incrementally to \$108,621 through October 1, 2004; semi-annual interest payments due April 1 and October 1; maturing in October 2004

310,335

5.25% - 5.00% General obligation refunding bonds, Series CS, of \$20,197 issued in April 1998 under Act 357, Session Laws of Hawaii 1997; annual principal payments of \$2,465 beginning April 1, 2003 and increasing incrementally to \$3,335 through April 1, 2009; semi-annual interest payments due April 1 and October 1; maturing in April 2009

20,197

Total long-term debt

2,226,411

Less current portion of long-term debt

489,982

Long-term debt - noncurrent

\$ 1,736,429

Principal payments to maturity on long-term debt are as follows:

Year ending June 30,

2003 \$ 489,982

2004 381,243

2005 386,645

2006 278,164

2007 278,323

Thereafter 412,054

\$ 2,226,411

8. Commitments and Contingencies

Risk Management

The Department's Risk Management Office handles tort claims of \$10,000 and less for most departments of the State. These claims are expensed when paid by the Department. The Department has not recorded a liability for unpaid tort claims of \$10,000 and less since the management of the Department has determined that the aggregate liability was not material at June 30, 2002. All other claims are handled by the State Department of the Attorney General. The State has a personal injury and property damage liability, including automobile and public errors and omissions, insurance policy in force with a \$2,000,000 deductible per occurrence. The annual aggregate per occurrence is \$15,000,000. The State also has a crime insurance policy for various types of coverage with a minimum limit of loss of \$1,000,000 per occurrence and a maximum limit of \$10,000,000 with a \$250,000 deductible.

Property and automobile insurance coverage for the State's facilities and automobiles is handled by the Department's Risk Management Office. Insurance coverage for the State's properties is obtained through various insurers over a \$250,000 deductible self-insured amount per occurrence. The deductible for windstorm coverage is 2% of loss subject to a \$250,000 per occurrence minimum. The limit of loss per occurrence is \$25,000,000. The policy includes earthquake, named hurricane, and flood coverage whose limit of loss per occurrence is \$10,000,000 with a deductible of 2% of loss subject to a \$250,000 minimum and a \$10,000,000 annual aggregate. The State's automobiles are self-insured for damage. These claims are expensed when paid by the Department. The Department has not recorded a liability for unpaid claims because the management of the Department has determined that this liability was not material at June 30, 2002. Worker's compensation insurance is maintained through another state department.

Litigation

The Department is involved in several lawsuits and complaints, which arose in the normal course of operations. Losses not covered by insurance are typically paid through an appropriation from the State's General Fund. Accordingly, the management of the Department is of the opinion that the outcome of these lawsuits and complaints will not have a material adverse effect on the financial position of the Department.

Operating Leases

The future minimum rent payments for years subsequent to June 30, 2002 for certain office space leased by the Department under noncancelable operating leases, which expire at various dates through August 2022, are as follows:

Year ending June 30,	
2003	\$ 8,444,000
2004	7,461,000
2005	6,160,000
2006	5,422,000
2007	4,862,000
Thereafter	56,558,000
	<u>\$ 88,907,000</u>

Total rent expenditures of the General Fund for the year ended June 30, 2002 approximated \$8,913,000.

Accumulated Sick Leave

Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service without limit. Sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, an employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 2002 approximated \$23,354,000 for the governmental fund types and approximately \$719,000 and \$1,181,000 for the proprietary fund types and component unit, respectively.

Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary to future years. The deferred compensation is not available to employees until termination, retirement, death, or an unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of the State's general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor.

Ceded Lands

In 1898, the Republic of Hawaii transferred certain lands to the United States. Upon Hawaii's admission to the Union in 1959, the United States reconveyed title to those lands (collectively, the ceded lands) back to the State to be held as a public trust for the support of the public schools and other public educational institutions, for the betterment of the conditions of native Hawaiians, for the development of farm and home ownership, for the making of public improvements and for provision of lands for public use.

In 1978, the State Constitution was amended expressly to provide that the ceded lands were to be held as a public trust for native Hawaiians and the general public, and to establish the Office of Hawaiian Affairs (OHA) to administer and manage the proceeds and income derived from a pro rata portion of the ceded lands for native Hawaiians.

In 1979, the State Legislature adopted HRS Chapter 10 which, as amended in 1980, specified, among other things, that OHA receive and expend 20% of all funds derived by the State from the ceded lands for the betterment of native Hawaiians.

In 1987, in *Trustees of the Office of Hawaiian Affairs v. Yamasaki*, 69 Haw. 154 (1987), the Hawaii Supreme Court concluded that HRS Chapter 10 was insufficiently clear regarding the amount of monies OHA was entitled to receive from the public land trust.

In 1990, in response to *Yamasaki*, the State Legislature adopted Act 304, Session Laws of Hawaii 1990, which (1) defined "public land trust" and "revenue," (2) specified that 20% of the "revenue" derived from the "public land trust" was to be expended by OHA for the betterment of native Hawaiians, and (3) established a process for OHA and the State Director of Finance to jointly

determine the amount of monies which the State would pay OHA to retroactively settle all of OHA's claims for the period from June 16, 1980 through June 30, 1991. Since fiscal 1992, the State, through its departments and agencies, has been paying 20% of "revenue" to OHA on a quarterly basis.

In 1993, the State Legislature enacted Act 35, Session Laws of Hawaii 1993, appropriating \$136.5 million to pay the amount determined to be OHA's claims, with interest, for the period from June 16, 1980 through June 30, 1991.

In January 1994, OHA and its Board of Trustees (the Plaintiffs) filed suit against the State (*OHA, et al. v. State of Hawaii, et al.*, Civil No. 94-0205-01 (First Circuit)), claiming that the amount paid to OHA was inadequate and alleging that the State has failed to properly account for and fully pay the pro rata share of proceeds and income derived from the public land trust. Among other things, the Plaintiffs seek an accounting for all proceeds and income, funds and revenue derived from the public land trust since 1978, and restitution or damages amounting to 20% of the proceeds and income derived from the public land trust, as well as interest thereon. In its answer to OHA's complaint, the State denied all of the Plaintiffs' substantive allegations, and asserted its sovereign immunity from suit and other jurisdictional and claim-barring defenses. The Plaintiffs, thereafter, filed motions for partial summary judgement as to the State's liability to pay OHA 20% of monies it receives from (1) Airports Division's in-bond duty-free airport concession (including receipts from the concessionaire's off-airport sales operations); (2) the state-owned and operated Hilo Medical Center; (3) the State's rental public housing projects and affordable housing developments; and (4) interest income, including investment earnings (collectively, the Sources). In response, the State filed a motion to dismiss on the basis of sovereign immunity and opposed Plaintiffs' four motions on the merits and raised several affirmative defenses.

On October 24, 1996, the Circuit Court of the First Circuit of the State of Hawaii (First Circuit Court) filed an order denying the State's motion to dismiss and rejecting its affirmative defenses. Also on October 24, 1996, the First Circuit Court filed an order granting the Plaintiffs' four motions for partial summary judgment with respect to the State's liability to pay OHA 20% of the monies it receives from each of the Sources, and deferred establishing amounts owed from those Sources for further proceedings or trial. The State's motion for leave to file an interlocutory appeal from both the order denying its motion to dismiss and the order granting the Plaintiffs' four motions for partial summary judgement was granted, and all proceedings in the suit have been stayed pending the Hawaii Supreme Court's disposition of the State's appeal.

On September 12, 2001, the Hawaii Supreme Court concluded that Act 304 was effectively repealed by its own terms, and that there were no juridically manageable standards by which to determine whether OHA was entitled to the revenue it sought from the Sources because the repeal of Act 304 revived the law which the Hawaii Supreme Court in *Yamasaki* had previously concluded was insufficiently clear to establish how much OHA was entitled to receive from the ceded lands. See *OHA v. State*, 96 Haw., 388 (2002). The Hawaii Supreme Court dismissed the case for lack of justiciability noting that it was up to the State Legislature to enact legislation to give effect to the right of native Hawaiians to benefit from the ceded lands under the State Constitution. The State Legislature took no action during the 2002 legislative session, and the State's payments of 20% of "revenue" were discontinued as of the first quarter in fiscal 2002.

The State currently is unable to predict with reasonable certainty the magnitude of its potential liability for such claims, if any. Resolution of all of OHA's claims could have a material adverse effect on the State's financial condition.

In a second lawsuit, OHA filed a complaint for declaratory and injunctive relief on November 4, 1994 (*OHA v. Housing Finance and Development Corporation, et al.*, Civil No. 94-4207-11 (First Circuit)) to enjoin the State from alienating any ceded lands or, alternatively, to preclude the extinguishing of any rights native Hawaiians may have in ceded lands which may be alienated.

On April 2, 1996, the First Circuit Court denied the Defendants' motion for partial summary judgement which sought a ruling that the State has the authority to alienate ceded lands. On March 12, 1998, the Defendants filed another motion (Motion to Dismiss Certain Counts and for Partial Summary Judgement) which the First Circuit Court heard on July 9, 1998 and denied on August 27, 1998. On September 3, 1998, the Defendants filed a Motion for Leave to File Interlocutory Appeal from Order Denying Motion. This motion was heard on September 24, 1998, and was denied on October 7, 1998. Trial for this concluded on December 4, 2001. The First Circuit Court has taken the case under advisement.

In a third lawsuit, OHA filed suit against the Hawaii Housing Authority (the HHA), the executive director of the HHA, the board members of the HHA and the State Director of Finance on July 27, 1995 (*OHA v. HHA, et al.*, Civil No. 95-2682-07 (First Circuit)) to secure additional compensation and an itemized accounting of the sums previously paid to OHA for five specifically identified parcels of ceded lands which were transferred to the HHA for its use to develop, construct and manage additional affordable public rental housing units under HRS Chapter 201G. On January 11, 2000, all proceedings in this suit were stayed pending the Hawaii Supreme Court's decision in the State's appeal in *OHA v. State of Hawaii*, Civil No. 94-0205-01 (First Circuit). The repeal and revival of the pre-Yamasaki law by the Hawaii Supreme Court's September 12, 2001 decision in *OHA v. State* should also require dismissal of the claims OHA makes in *OHA v. HHA*.

At the present time, the State is not able to estimate with any reasonable certainty the magnitude of the potential liability as it may be determined either by judicial rulings (either at trial or on appeal) or by legislation enacted as a result of the process established in Act 329. Accordingly, no estimate of loss has been made in the State's or the accompanying financial statements. However, an ultimate decision against the State could have a material adverse effect on the financial position of the State.

9. Accounting Changes and Restatements

During fiscal 2002, the Department adopted GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. The Department also raised the capitalization threshold for capital assets from \$1,000 to \$5,000 (historical treasures, works of art, furniture and equipment and motor vehicles) and \$100,000 (land improvements and buildings).

The accumulated depreciation balances at July 1, 2001 were restated to record accumulated depreciation in accordance with the adoption of GASB Statement No. 34. The gross cost balances at July 1, 2001 were also restated to reflect the above increase in the Department's capitalization threshold.

The following table shows beginning net assets restated for the effects of the implementation of GASB Statement No. 34 and change in accounting policy:

Fund balance as previously reported at July 1, 2001	\$ 672,389,687
GASB Statement No. 34 and accounting policy adjustments:	
Net capital assets (Note 4)	(37,656,316)
Liability recognition:	
Accrued vacation payable	<u>(7,082,336)</u>
Net assets at July 1, 2001, as restated	<u><u>\$ 627,651,035</u></u>

State of Hawaii
Department of Accounting and General Services
Combining Balance Sheet - General Fund Programs

June 30, 2002

	Administration and support	School repair and maintenance	State procurement	Accounting	Audit	Public building maintenance	Performing and visual arts	Office leasing	Information processing services	Communication	Others	Total
ASSETS:												
Cash in state treasury	\$ 270,184	\$ 2,358,474	\$ 32,997	\$ 651,507	\$ 1,048,521	\$ 1,852,191	\$ 931,577	\$ 14,777,394	\$ 2,067,949	\$ 556,416	\$ 480,923	\$ 25,028,133
Inventories	-	-	-	-	-	-	-	-	-	-	1,094,141	1,094,141
Total assets	<u>\$ 270,184</u>	<u>\$ 2,358,474</u>	<u>\$ 32,997</u>	<u>\$ 651,507</u>	<u>\$ 1,048,521</u>	<u>\$ 1,852,191</u>	<u>\$ 931,577</u>	<u>\$ 14,777,394</u>	<u>\$ 2,067,949</u>	<u>\$ 556,416</u>	<u>\$ 1,575,064</u>	<u>\$ 26,122,274</u>
LIABILITIES:												
Vouchers and contracts payable	\$ 51,071	\$ 1,249,980	\$ -	\$ 10,374	\$ 8,206	\$ 711,498	\$ 478,152	\$ 565	\$ 706,827	\$ 57,222	\$ 123,753	\$ 3,397,648
Total liabilities	<u>51,071</u>	<u>1,249,980</u>	<u>-</u>	<u>10,374</u>	<u>8,206</u>	<u>711,498</u>	<u>478,152</u>	<u>565</u>	<u>706,827</u>	<u>57,222</u>	<u>123,753</u>	<u>3,397,648</u>
FUND BALANCES												
Reserved for encumbrances	219,113	1,108,494	32,997	641,133	1,040,315	1,140,693	453,425	14,776,829	1,361,122	499,194	357,170	21,630,485
Reserved for inventories	-	-	-	-	-	-	-	-	-	-	1,094,141	1,094,141
Total fund balances	<u>219,113</u>	<u>1,108,494</u>	<u>32,997</u>	<u>641,133</u>	<u>1,040,315</u>	<u>1,140,693</u>	<u>453,425</u>	<u>14,776,829</u>	<u>1,361,122</u>	<u>499,194</u>	<u>1,451,311</u>	<u>22,724,626</u>
Total liabilities and fund balances	<u>\$ 270,184</u>	<u>\$ 2,358,474</u>	<u>\$ 32,997</u>	<u>\$ 651,507</u>	<u>\$ 1,048,521</u>	<u>\$ 1,852,191</u>	<u>\$ 931,577</u>	<u>\$ 14,777,394</u>	<u>\$ 2,067,949</u>	<u>\$ 556,416</u>	<u>\$ 1,575,064</u>	<u>\$ 26,122,274</u>

State of Hawaii
Department of Accounting and General Services
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances - General Fund Programs

For the Year Ended June 30, 2002

	Administration and support	School repair and maintenance	State procurement	Accounting	Audit	Public building maintenance	Performing and visual arts	Office leasing	Information processing services	Communication	Others	Total
Revenues	\$ 2,218,750	\$ 23,258,540	\$ 971,234	\$ 2,197,001	\$ 1,291,995	\$ 16,116,181	\$ 2,281,143	\$ 12,822,611	\$ 12,183,401	\$ 2,116,267	\$ 2,881,702	\$ 78,339,825
Expenditures:												
Personal services	2,033,864	9,162,123	865,618	1,554,838	672,520	5,512,123	299,987	191,784	7,586,325	353,691	2,635,014	30,867,887
Operating and maintenance	265,821	14,353,102	73,597	659,999	975,735	8,817,942	1,647,361	10,860,876	5,189,453	1,830,706	525,369	45,199,961
Total expenditures	2,299,685	23,515,225	939,215	2,214,837	1,648,255	14,330,065	1,947,348	11,052,660	12,775,778	2,184,397	3,160,383	76,067,848
Excess of revenues over (under) expenditures before transfers and other changes in fund equity	(80,935)	(255,685)	32,019	(17,836)	(356,260)	1,786,116	333,795	1,769,951	(592,377)	(68,130)	(278,681)	2,271,977
Interfund transfers in	300,292	331,000	-	136,115	652,183	-	(78,088)	-	455,152	27,607	437,588	2,261,849
Interfund transfers out	-	(2,846,906)	(4,134)	-	-	(564,008)	-	(94,683)	-	-	-	(3,509,731)
Excess of revenues over (under) expenditures and transfers before other changes in fund equity	219,357	(2,771,591)	27,885	118,279	295,923	1,222,108	255,707	1,675,268	(137,225)	(40,523)	158,907	1,024,095
Other changes in fund equity:												
Lapsed appropriations	(24,935)	(81,068)	(8,334)	(26,185)	(8,398)	(479,087)	(219,155)	(2,023,729)	(164,582)	(28,083)	(43,523)	(3,105,079)
Decrease in reserve for inventories	-	-	-	-	-	-	-	-	-	-	(413,954)	(413,954)
Excess of revenues over (under) expenditures, transfers and other changes in fund equity	194,422	(2,852,659)	19,551	92,094	289,525	743,021	36,552	(348,461)	(301,807)	(68,606)	(298,570)	(2,494,938)
Fund balances - beginning	24,691	3,961,153	13,446	549,039	750,790	397,672	416,873	15,125,290	1,662,929	567,800	1,749,881	25,219,564
Fund balances - ending	\$ 219,113	\$ 1,108,494	\$ 32,997	\$ 641,133	\$ 1,040,315	\$ 1,140,693	\$ 453,425	\$ 14,776,829	\$ 1,361,122	\$ 499,194	\$ 1,451,311	\$ 22,724,626

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Combining Balance Sheet - Other Governmental Funds

June 30, 2002

	Risk management	Performing and visual arts	All others	Total
ASSETS:				
Cash in state treasury	\$ 6,869,850	\$ 6,845,564	\$ 2,034,579	\$ 15,749,993
Total assets	<u>\$ 6,869,850</u>	<u>\$ 6,845,564</u>	<u>\$ 2,034,579</u>	<u>\$ 15,749,993</u>
LIABILITIES:				
Vouchers and contracts payable	\$ -	\$ 167,106	\$ 166,423	\$ 333,529
Due to others	12,102,524	-	-	12,102,524
Total liabilities	<u>12,102,524</u>	<u>167,106</u>	<u>166,423</u>	<u>12,436,053</u>
FUND BALANCES:				
Reserved for encumbrances	-	1,246,871	6,359	1,253,230
Reserved for continuing appropriations	-	-	115,571	115,571
Unreserved	(5,232,674)	5,431,587	1,746,226	1,945,139
Total fund balances	<u>(5,232,674)</u>	<u>6,678,458</u>	<u>1,868,156</u>	<u>3,313,940</u>
Total liabilities and fund balances	<u>\$ 6,869,850</u>	<u>\$ 6,845,564</u>	<u>\$ 2,034,579</u>	<u>\$ 15,749,993</u>

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances - Nonmajor Governmental Funds

For the Year Ended June 30, 2002

	Risk management	Performing and visual arts	All others	Total
Revenues:				
Insurance	\$ 7,737,856	\$ -	\$ -	\$ 7,737,856
Intergovernmental	69,918	460,000	-	529,918
Rentals	-	-	4,920,931	4,920,931
CIP assessments	-	-	909,792	909,792
Other income	-	-	1,244,038	1,244,038
Interest	377,966	338,296	66,719	782,981
Total revenues	<u>8,185,740</u>	<u>798,296</u>	<u>7,141,480</u>	<u>16,125,516</u>
Expenditures:				
Personal services	-	590,546	310,653	901,199
Operating and maintenance	5,706,901	1,361,655	7,016,302	14,084,858
Total expenditures	<u>5,706,901</u>	<u>1,952,201</u>	<u>7,326,955</u>	<u>14,986,057</u>
Excess of revenues over (under) expenditures before transfers and other changes in fund equity	2,478,839	(1,153,905)	(185,475)	1,139,459
Interfund transfers in	3,214,357	8,857,142	1,400	12,072,899
Interfund transfers out	(3,462,256)	(7,774,947)	2,114,148	(9,123,055)
Excess of revenues over (under) expenditures and transfers before other changes in fund equity	<u>2,230,940</u>	<u>(71,710)</u>	<u>1,930,073</u>	<u>4,089,303</u>
Other changes in fund equity:				
Lapsed appropriations	-	(2,021,513)	(2,114,473)	(4,135,986)
Excess of revenues over (under) expenditures, transfers and other changes in fund equity	2,230,940	(2,093,223)	(184,400)	(46,683)
Fund balances - beginning	(7,463,614)	8,771,681	2,052,556	3,360,623
Fund balances - ending	<u>\$ (5,232,674)</u>	<u>\$ 6,678,458</u>	<u>\$ 1,868,156</u>	<u>\$ 3,313,940</u>



GERALD Y. USHIJIMA

CERTIFIED PUBLIC ACCOUNTANT

1110 UNIVERSITY AVE. SUITE 508

HONOLULU, HAWAII 96826

TEL: (808) 949-5588

FAX: (808) 949-2666

E-MAIL: GYUCPA@AOL.COM

WWW.USHIJIMACPA.COM

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL
CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING
STANDARDS***

Comptroller
State of Hawaii

We have audited the basic financial statements of the Department of Accounting and General Services, State of Hawaii, as of and for the year ended June 30, 2002, and have issued our report thereon dated March 28, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Department of Accounting and General Services, State of Hawaii's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes), and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted a certain immaterial instance of noncompliance, which is described in Section II as Procurement of Goods and Services.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department of Accounting and General Services, State of Hawaii's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the

internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the management of the Department of Accounting and General Services, State of Hawaii, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Ann M. Kington", with a long, sweeping horizontal line extending to the right.

March 28, 2003



GERALD Y. USHIJIMA

CERTIFIED PUBLIC ACCOUNTANT

1110 UNIVERSITY AVE. SUITE 508
HONOLULU, HAWAII 96826

TEL: (808) 949-5588

FAX: (808) 949-2666

E-MAIL: GYUCPA@AOL.COM

WWW.USHIJIMACPA.COM

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

Comptroller
State of Hawaii

Compliance

We have audited the compliance of the Department of Accounting and General Services, State of Hawaii, with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2002. The Department of Accounting and General Services, State of Hawaii's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Department of Accounting and General Services, State of Hawaii's management. Our responsibility is to express an opinion on the Department of Accounting and General Services, State of Hawaii's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department of Accounting and General Services, State of Hawaii's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Department of Accounting and General Services, State of Hawaii's compliance with those requirements.

In our opinion, the Department of Accounting and General Services, State of Hawaii, complied, in all material respects with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2002.

Internal Control Over Compliance

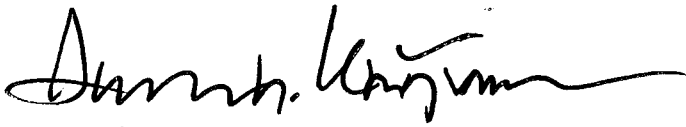
The management of the Department of Accounting and General Services, State of Hawaii, is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department of Accounting and General Services, State of Hawaii's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Department of Accounting and General Services, State of Hawaii, as of and for the year ended June 30, 2002, and have issued our report thereon dated March 28, 2003. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the management of the Department of Accounting and General Services, State of Hawaii, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Kenneth K. Kama", with a long horizontal flourish extending to the right.

March 28, 2003

State of Hawaii
Department of Accounting and General Services
Supplemental Information - Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2002

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Grant Period</u>	<u>Grant Amount</u>	<u>Expenditures</u>
<u>U.S. General Services Administration</u>					
Donation of Federal Surplus Personal Property	39.003				\$ 741,603
<u>National Endowment for the Arts</u>					
State and Regional Program	45.007	99-6100-2043	7/1/99 - 10/15/01	\$ 453,900	38,991
		00-6100-2044	7/1/00 - 7/31/02	\$ 476,800	206,698
		01-6100-2054	7/1/01 - 7/31/03	\$ 506,900	304,745
					<u>550,434</u>
Total Expenditures of Federal Awards					<u>\$ 1,292,037</u>

The accompanying note is an integral part of the schedule of expenditures of federal awards.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

NOTE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
JUNE 30, 2002

1. FEDERAL SURPLUS PROPERTY PROGRAM

All assistance provided to the Federal Surplus Property Program is in the form of donations of excess property to the Department of Accounting and General Services, State of Hawaii (the Department). For the year ended June 30, 2002, the Department processed federal property valued at \$3,182,846, the federal government's original acquisition cost. For OMB Circular A-133 purposes, the donated property is valued at 23.3% of the federal government's original acquisition cost. This is the expenditure amount shown on the schedule of expenditures of federal awards. The ending inventory at June 30, 2002, carried at the federal government's original acquisition cost, was \$2,568,096.

State of Hawaii
Department of Accounting and General Services
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2002

Section I – Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: unqualified

Internal control over financial reporting:

- Material weakness(es) identified? _____ yes ☒ no
- Reportable condition(s) identified that are not considered to be material weaknesses?
_____ yes ☒ none reported
- Noncompliance material to financial statements noted? _____ yes ☒ no

Federal Awards

Internal controls over major programs:

- Material weakness(es) identified? _____ yes ☒ no
- Reportable condition(s) identified that are not considered to be material weaknesses?
_____ yes ☒ none reported

Type of auditors' report issued on compliance for major programs: unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? _____ yes ☒ no

Identification of major programs:

CFDA Number(s)

Name of Federal Program or Cluster

39.003

Donation of Federal Surplus Personal Property

45.007

State and Regional Program

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualifies as low-risk auditee? ☒ yes _____ no

State of Hawaii
Department of Accounting and General Services
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2002

Section II – Financial Statement Findings

Procurement of Goods and Services

During the fall of 2001, the Department of Accounting and General Services, State of Hawaii (the Department), issued requests for proposals (RFP) for design and build reroofing projects covering maintenance and repair work to be performed at three school locations. A protest was filed against these RFPs. The existence of this protest should have halted all activities associated with the RFPs.

Despite the protest, internal recommendations for project awards were approved in late December 2001, and as set forth in the RFPs, the Department was to have issued letters of award to the selected contractors, followed by the contractors providing notices of their acceptance. This was to have been followed by the Department's issuance of a notice to proceed to the contractors and, at about the same time, the execution of a written contract (collectively referred to as pre-construction documentation). The pre-construction documentation requirements were not met prior to the commencement of work on these projects – but in their absence, the Department allowed the contractors to proceed with work “at their own risk”. Construction activities indeed commenced on these school projects despite the existence of the protest and the lack of required pre-construction documentation.

The continuation of activities associated with the RFPs despite the existence of a protest and lack of pre-construction documentation prior to the commencement of construction activities represent non-compliance with the RFPs and the Hawaii Public Procurement Code (Chapter 103D, Hawaii Revised Statutes).

We recommend that the Department institute procedures to readily identify the existence of outstanding protests and halt all activities associated with RFPs until issues associated with any protest are resolved. Additionally, the Department should execute the required pre-construction documentation prior to the commencement of construction activities.

State of Hawaii
Department of Accounting and General Services
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2002

Section III – Federal Award Findings and Questioned Costs

None